

GARMAN TURNER GORDON LLP
GERALD M. GORDON, ESQ.
Nevada Bar No. 229
E-mail: ggordon@gtg.legal
MARK M. WEISENMILLER, ESQ.
Nevada Bar No. 12128
E-mail: mweisenmiller@gtg.legal
650 White Drive, Ste. 100
Las Vegas, Nevada 89119
Telephone 725-777-3000
Facsimile 725-777-3112
Attorneys for the Herbst Parties

**UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEVADA**

In re:

CONSOLIDATED NEVADA CORPORATION,

Debtor.

Case No.: BK-S-13-51236-GWZ
Chapter: 7

Hearing:
Date: January 24, 2017
Time: 2:00 p.m.

**OPPOSITION TO MOTION FOR AUTHORITY TO FILE AND PROSECUTE CLAIMS
ON BEHALF OF BANKRUPTCY ESTATE OR, IN THE ALTERNATIVE,
TO COMPEL ABANDONMENT OF CLAIMS**

JH, Inc. ("JH"), Jerry Herbst ("Herbst"), and Berry-Hinckley Industries ("BHI" and collectively with JH and Herbst, the "Herbst Parties"), by and through their counsel, the law firm of Garman Turner Gordon LLP, hereby submit this opposition (the "Opposition") to the *Motion for Authority to File and Prosecute Claims on Behalf of Bankruptcy Estate or, in the Alternative, to Compel Abandonment of Claims* [ECF No. 131] (the "Motion"), filed by Paul A. Morabito ("Morabito") and Consolidated Nevada Corporation ("CNC," and together with Morabito, the "Debtors") on December 27, 2016. The Motion is supported by the *Declaration of Paul A. Morabito in Support of Motion for Authority to File and Prosecute Claims on Behalf of Bankruptcy Estate or, in the Alternative, to Compel Abandonment of Claims* [ECF No. 132] (the "Morabito Declaration"). The Motion seeks to authorize Debtors and their counsel to prosecute the Complaint, which was filed before the Second Judicial District for the State of Nevada in and for the County of Washoe on December 16, 2016, and removed to this Court on December 23, 2016 [ECF No. 733 in Bankruptcy Case No. 13-51237-GWZ] (the "Complaint").

This Opposition is made and based upon the memorandum of points and authorities set

1 forth below, the declarations of Brian R. Irvine (the “Irvine Decl.”) and Mark M. Weisenmiller
 2 (the “Weisenmiller Decl.”), filed concurrently herewith, the pleadings, papers, and other records
 3 on file with the clerk of the above-captioned Court, judicial notice of which is hereby
 4 respectfully requested under Federal Rule of Evidence 201, and any argument of counsel
 5 entertained by the Court at the time of the hearing on the Motion.

6 MEMORANDUM OF POINTS AND AUTHORITIES

7 I. 8 INTRODUCTION

9 Put simply, Morabito is seeking to relitigate the State Court Action now couched as an
 10 effort to prosecute on behalf of the Estates causes of action which he acknowledges arose prior to
 11 the commencement of the Debtors’ bankruptcy cases and are property of the Estates. The crux
 12 of Morabito’s alleged Claims (defined below) is that — as a result of alleged fraudulent conduct
 13 to the tune of \$3.6 million (which the Herbst Parties denied during the State Court Action and
 14 once again deny), which miraculously through a series of fortuitous Facebook encounters in
 15 September 2016, has only now been discovered by Morabito and his counsel, the State Court
 16 entered the Judgment; and, had the alleged fraud been known at the time, the Judgment and
 17 Confessed Judgment would never have been entered. This is ludicrous and preposterous, and
 18 any reasonable person by simply reading the State Court FF&CL and Judgment would arrive at
 19 that conclusion. This is nothing more than another Morabito fabrication, which his counsel
 20 could and should have obviously realized if they had simply done what is required of them
 pursuant to FRBP 9011(b) — a reasonable inquiry under the circumstances.

21 First, the issue of Western Energetix/Nella Oil and BHI and accounts payable/accounts
 22 receivable, and the concept of Walt Dwelle as a witness that would help Morabito’s position, is
 23 nothing new. These exact issues were presented to, considered, and rejected by the independent
 24 accountant (the “IA”) prior to the issuance of his final working capital calculation in June 18,
 25 2009, which resulted in an order of the State Court on August 12, 2009 confirming the
 26 calculation (the “Working Capital Order”) that was appealed to the Nevada Supreme Court and
 27 dismissed by stipulation of the parties. Despite this, the Debtors sought to unsuccessfully
 28 relitigate working capital dispute during the State Court trial, resulting in significant findings of

fact by the State Court.

Second, the alleged Claims are not colorable because: (i) the factual allegations in the Complaint are not plausible considering the 2009 Working Capital Order and the State Court's FF&CL and Judgment entered in September 2010 for fraud; (ii) the alleged Claims are barred by claim and issue preclusion because Morabito raised the factual basis of the alleged Claims to the IA and State Court at the time of the State Court Action and should have raised the alleged Claims in the Confessed Judgment Action; (iii) the Complaint is untimely; and (iv) Debtors lacked standing to file the Complaint.

Third, Morabito failed to disclose the alleged Claims on his schedules or statements, including the amendments filed in December 2016, and provided no information to the Trustee at his 341 meetings, including his continued 341 meeting on December 5, 2016 after he allegedly learned of the alleged Claims by "pure happenstance" in September 2016, months before filing the Complaint on December 16, 2016. Morabito and his counsel knew of the basis for the alleged Claims in 2008 and raised them before the IA and the State Court so there is simply no excuse for failing to disclose the alleged Claims in the Chapter 7 Cases.

Fourth, under the circumstances, the Chapter 7 Trustee's inaction prior to the filing of the Complaint and any similar position taken since the filing of the Complaint cannot be viewed as an abuse of discretion in light of his duties in the Chapter 7 Cases. Thus, the Debtors cannot meet any of the four elements required under applicable law to be granted derivative standing to prosecute the Complaint and the Claims being asserted therein. Consequently, the Motion should be denied.

II. PERTINENT FACTS

A. The Dispute, the Trial, and the State Court Judgment.

1. JH and P.A. MORABITO & CO. Ltd. ("PAMCO"), the predecessor-in-interest to CNC, entered into an *Amended and Restated Stock Purchase Agreement* dated June 28, 2007 (the "ARSPA"), whereby JH was to purchase the stock of BHI from PAMCO. Herbst was the guarantor of the JH obligations under the ARSPA, and Morabito guaranteed the obligations of

1 PAMCO.

2 2. A dispute developed between Debtors and the Herbst Parties regarding the sale of
3 the BHI stock to JH. Debtors filed a lawsuit against the Herbst Parties on December 3, 2007,
4 captioned *Consolidated Nevada Corp., et al. v. JH. et al.*, in Department 6 of the Second Judicial
5 District Court in and for the County of Washoe (the “State Court”), Case No. CV07-02764
6 (together with all claims and counterclaims, the “State Court Action”). The Herbst Parties filed
7 numerous counterclaims in the State Court Action against Debtors, including, but not limited to,
8 fraud in the inducement, misrepresentation, and breach of contract.

9 3. On April 17, 2009, Debtors’ counsel in the State Court Action, Leif Reid,
10 transmitted a letter to the IA (the “April 17 Letter”), which raised issues that Morabito had with
11 the accounts payable detail the Herbst Parties’ included in their working capital report as of July
12 2, 2007, specifically with respect to liabilities and assets that Morabito contended should have
13 been associated with Nella Oil/Western Energetix, not BHI. See Exhibit 1 to the Irvine
14 Declaration, ¶ 3.

15 4. The April 17 Letter requested that the IA speak with the owner of Nella
16 Oil/Western Energetix, Walter Dwelle (“Dwelle”), and that Dwelle would provide an affidavit
17 supporting Morabito’s claim. See id.

18 5. The IA asked that the Debtors provide him with the specific accounts, vendors,
19 transactions or any other detail relating to Debtors’ allegations that certain of BHI’s reported
20 liabilities were the financial obligation of an entity other than BHI so that the IA could consider
21 and investigate Debtors’ claims through their review process. See Exhibits 1 and 2 to the Irvine
22 Declaration, ¶¶ 3-4.

23 6. On April 21, 2009, the IA spoke with Dwelle by telephone regarding Morabito’s
24 allegations in the April 17 Letter. However, Dwelle suggested that no Nella Oil/Western
25 Energetix accounts payable or other transactions should be in the BHI financials as of July 2007
26 because the sale closed in January 2007 and any commingling of the companies’ activities would
27 have ceased well before July 2007. See id.

28 7. On April 23, 2009, Shepard Mullin, counsel to the IA, responded to the April 17

1 Letter, addressing each and every point raised in the April 17 Letter, including the assertions
2 regarding Nella Oil/Western Energetix. See Exhibit 3 to the Irvine Declaration, ¶ 5.

3 8. Morabito often promised to provide an affidavit or other testimony from Dwelle
4 to support his allegations, but never did. See Irvine Decl., ¶ 6.

5 9. On June 18, 2009, the IA submitted to the State Court the final working capital
6 report and on August 12, 2009, the State Court entered the Working Capital Order. See Exhibit
7 4 attached to the Irvine Declaration, ¶ 7.

8 10. On August 19, 2009, the Debtors appealed the Working Capital Order to the
9 Nevada Supreme Court. See Exhibit 5 attached to the Irvine Declaration, ¶ 8. On November
10 17, 2011, the appeal was dismissed. See Exhibit 6 attached to the Irvine Declaration, ¶ 9.

11 11. On or about March 26, 2010, Jones Vargas, counsel for the Herbst Parties, filed
12 with the State Court the *[Second] Amended Expert Report of Craig I. Greene, CPA/CFF, CFE,*
13 *MCJ* (the “Expert Report”). See Exhibit 7 to the Irvine Declaration, ¶ 10.

14 12. One excerpt of the Expert Report (pages 20 and 21) further substantiates that the
15 Nella/Western Energetix transaction with BHI was fully explored and investigated. A second
16 excerpt from the Expert Report (pages 81 and 82) illustrates that the Nella Oil/Western Energetix
17 transaction actually harmed BHI because of the losses inherent in the undisclosed agreement
18 regarding the cost of fuel. Finally, another excerpt from the Expert Report (Exhibit 16)
19 evidences the third component of damages, \$66,002,205.75, awarded by the State Court in the
20 Judgment as more particularly described below. See id.

21 13. The State Court Action was tried before the Honorable Judge Brent Adams by
22 way of a bench trial commencing May 10, 2010 and lasted several weeks.

23 14. On October 12, 2010, the State Court entered findings of fact and conclusions of
24 law (the “FF&CL”) in the State Court Action, which specifically set forth the legal and factual
25 basis for judgment against Morabito for fraud in the inducement. The State Court concluded that
26 Morabito and CNC defrauded the Herbst Parties in three (3) specific ways and awarded damages
27 for two components, which totaled \$85,871,363.75. See Exhibit 8 attached to the Irvine
28 Declaration, ¶ 11.

15. As to the Herbst Parties' fraud allegations with respect to Morabito's representations regarding construction manager services in the CMA, the State Court concluded that in the FF&CL:

2. Fraud in the Inducement

69. The Court finds by clear and convincing evidence that Mr. Morabito never for a single second had any intention to perform the services of construction manager.

70. Mr. Morabito's representations under the CMA were intentionally false.

73. As a result, [the Herbst Parties] have been damaged in the sum of \$19,869,159.

See id. at ¶¶ 69-70, 73 (citations omitted).

16. With respect to the Herbst Parties' losses due to Morabito's fraud as a result of buying BHI, including consideration of BHI's monthly losses, accounts payable, and the working capital estimate, the State Court also concluded in the FF&CL that:

34. Clear and convincing evidence shows that there was no basis whatsoever for the contents of the working capital estimate other than Mr. Morabito's decision to create it.

35. There is not one piece of paper that has been produced in over 5,500 exhibits in this trial, to the Independent Accountants, during discovery or anywhere else, to support the exaggerated value of the company as set forth in the working capital estimate.

36. The major difference between Mr. Morabito's estimate and the actual working capital is accounts payable. This fact is significant.

37. The Court is very impressed with the testimony of Paula Meyer. Ms. Meyer worked for BHI since approximately 1995. She worked for years under the direction of Mr. Hinckley, who impressed the Court as an honest and fine business person. Ms. Meyer is also a CPA and was the CFO of BHI. Ms. Meyer graduated from the University of Nevada, Reno and was an accountant at Grant, Thornton.

43. In the course of events leading to the closing of this transaction, there was a point where Mr. Morabito wanted Ms. Meyer to communicate only with him and not the lawyers or BCC. This is a small fact, but it is an unusual fact. This is a complex transaction involving tens of millions of dollars. As the CFO, Ms. Meyer had access to the financial statements of the company while the CEO of the company, Mr. Morabito, did not have such access. Nevertheless, Mr. Morabito

1 instructed Ms. Meyer to only communicate with him. Thus, the buyer was
2 deprived of access to Ms. Meyer (who knew the true financial condition of the
3 company) and had to rely exclusively on the false working capital estimate
prepared by Mr. Morabito.

4 44. Ms. Meyer testified that she did not know what happened to information once
5 it went to Mr. Morabito. Mr. Morabito handled the majority of the information.

6 45. Ms. Meyer's testimony regarding her constant disputes and disagreements
7 with Paul Morabito about the accounts payable was very moving.

8 46. It is not enough to say Ms. Meyer constantly had disagreements with Mr.
9 Morabito about the amount of accounts payable. Ms. Meyer's anxiety and fear of
10 this man because of his relentless, torturous attacks on her to drive down the
accounts payable was almost palpable as she testified. Her testimony sounded
more like the accounts the Court hears in cases of spousal abuse than in cases of
commercial transactions.

11 47. Ms. Meyer was then shown the document prepared by Mr. Morabito and she
12 knew in the flicker of an eye that it was way off.

13 48. Ms. Meyer testified that monthly accounts payable should have been in the
14 range of at least five to six million. Ms. Meyer had no idea why Mr. Morabito
made the representation he did.

15 49. Mr. Morabito always thought accounts payable should be lower. It was always
16 a battle back and forth between Mr. Morabito and Ms. Meyer.

17 50. Mr. Stanton Bernstein, Mr. Morabito's personal accountant, agreed with Ms.
18 Meyer regarding accounts payable.

19 51. Ms. Karen Scarborough, the BHI controller, also agreed with Ms. Meyer.

20 53. On or about March 8, 2007, the accounts payable totaled \$7,405,342.33.

21 55. Ms. Meyer told Mr. Morabito on the telephone many times that she knew the
22 payables were way too low.

23 59. The working capital estimate Mr. Morabito gave the buyer had no basis in
24 reality. It was contrary to what he knew firsthand to be the truth.

25 93. Clear and convincing evidence shows that there was no basis whatsoever for
26 the contents of the working capital estimate other than Mr. Morabito's decision to
27 create it. [The Herbst Parties] proved, by clear and convincing evidence, that Mr.
28 Morabito's statements of working capital were false and known by him to be
false, that [the Herbst Parties] reasonably relied on Mr. Morabito's statements of
working capital, and were damaged thereby.

1 94. Generally speaking, an estimate of value cannot be the basis for a legal claim
2 for fraud or other misconduct. However, the circumstances in this case are
3 different.

4 a. First, the estimate was prepared by Mr. Morabito, the owner of the
5 company.

6 b. Second, the estimate was significantly and materially inconsistent
7 with the information he was given firsthand by his chief financial
8 officer and by his personal accountant.

9 c. Third, there is no evidence that anyone else reviewed the estimate
10 that was prepared by Mr. Morabito.

11 95. There is simply no other conclusion available than the working capital report
12 that was prepared by Mr. Morabito was intentionally false, was done for the
13 purpose of [the Herbst Parties] relying on it, and that [the Herbst Parties] did
14 reasonably rely on it.

15 96. There is no data in the company to support the working capital estimate.

16 97. Mr. Morabito knew firsthand from his own employees and from his own
17 accountant that it was incorrect.

18 98. The working capital estimate was materially inflated and falsely inflated the
19 value of the company, and that became apparent shortly after close of the
20 transaction.

21 103. In December of 2006, [the Herbst Parties] were told BHI was losing about
22 \$600,000 a year. [Debtors'] own analysis indicated the company was losing
23 approximately \$1.5 million a year. In relatively short order, it turns out the
24 company was losing approximately \$1 million a month. Thus, it is reasonable, as
25 Mr. Greene suggested, to extrapolate from performance to the truthfulness or
26 untruthfulness of the representations concerning the value of BHI.

27 104. This evidence is not sufficient to warrant a finding of fraud or to award
28 damages with respect to the representations of the value of BHI.

105. However, these facts demonstrate that had Defendants known the truth
about the working capital, they would not have bought the company

106. The Court, having found that defendants were fraudulently induced, awards
damages to [the Herbst Parties] and against [the Morabito Parties] in the amount
of \$66,002,205.75.

See id. ¶¶ 34-37, 43-51, 55, 93-98, 103-06 (citations omitted).

17. Based upon the FF&CL, the State Court awarded total compensatory damages to

1 the Herbst Parties in the amount of \$85,871,364.75 for fraud in the inducement. See id. at 14-15.

2 18. After discovery, the State Court entered a judgment awarding the Herbst Parties
3 total damages in the amount of \$149,444,777.80, representing both compensatory and punitive
4 damages (the “State Court Judgment”) on August 23, 2011.

5 19. After entry of the State Court Judgment, Debtors filed numerous appeals with the
6 Nevada Supreme Court, denominated as Supreme Court Case Nos. 57943, 57944, 59138, and
7 54412. The Herbst Parties also filed numerous cross-appeals (together with the appeals filed by
8 Morabito, the “Appeals”).

9 **B. Settlement Agreement, Default, and Confessed Judgment.**

10 20. The Herbst Parties and Debtors, with the advice of counsel, agreed to settle the
11 State Court Action and the Appeals and, on November 30, 2011, executed the *Settlement*
12 *Agreement and Mutual Release* (the “Settlement Agreement”).

13 21. Pursuant to the Settlement Agreement and subsequent to its execution, the
14 Appeals were vacated, as were the State Court Judgment and the FF&CL.

15 22. As part of the Settlement Agreement, Morabito agreed to (i) make several cash
16 payments to the Herbst Parties, (ii) assume certain obligations of the Herbst Parties, (iii)
17 indemnify, defend, and hold harmless the Herbst Parties for certain claims in certain actions, and
18 (iv) list for sale certain real property for the benefit of the Herbst Parties.

19 23. As part of the Settlement Agreement, Morabito also agreed to execute (i) a
20 confession of judgment for \$85,000,000 (the “Confession of Judgment”) which included a
21 statement of facts and conclusions of law from the FF&CL which were subsequently vacated.

22 24. Morabito defaulted under the terms of the Settlement Agreement as a result of his
23 failure to timely comply with the terms of the Settlement Agreement, including his failure to pay
24 to the Herbst Parties the cash payment of \$4,000,000 due on or before March 1, 2013 (the
25 “Continuing Defaults”).

26 25. Morabito thereafter requested that the Herbst Parties forbear from exercising their
27 rights and remedies under the Settlement Agreement with respect to the Continuing Defaults
28 until December 1, 2013.

26. Accordingly, Morabito and the Herbst Parties, with the advice of counsel, entered into that certain Forbearance Agreement dated March 1, 2013 (the “Forbearance Agreement”).

27. As a result of Morabito’s breach of the Settlement Agreement and Forbearance Agreement, the Herbst Parties filed with the Clerk of the State Court the Confession of Judgment and the Stipulation of Nondischargeability on June 18, 2013 (the “Confessed Judgment Action”).

28. The Confessed Judgment was entered onto the judgment roll by the Clerk of the State Court.

29. The State Court in the Confessed Judgment Action held that the filing of the Confessed Judgment was proper and in compliance with the applicable Nevada Revised Statutes.

30. Morabito’s challenges to the Confessed Judgment were also denied by the Nevada Supreme Court.

31. The time to appeal the Confessed Judgment has expired.

C. The Involuntary Proceedings.

32. On June 20, 2013 (the “Petition Date”), the Herbst Parties filed an involuntary petition for relief under Chapter 7 of the Bankruptcy Code [ECF No. 1] (the “Involuntary Petition”), thereby commencing a Chapter 7 involuntary proceeding (the “Involuntary Proceeding”) against CNC.

33. On December 22, 2014, the Court entered its *Amended Order for Relief Under Chapter 7* [ECF No. 63].

D. Debtors’ Schedules, Statements, and 341 Meetings.

34. Debtors did not list the alleged Claims in their schedules or statements, which were amended several times, and did not provide any information to the Chapter 7 trustee at their 341 meetings, including Morabito’s continued 341 meeting conducted on December 5, 2016, just ten-days prior to the filing of the Complaint. See ECF Nos. 88. See also ECF Nos. 211, 237-38, 249, 685, 687 in 13-51237-GWZ; **Exhibit 9** to the Weisenmiller Declaration for the relevant portions of the continued 341 meeting transcript.

E. The Nondischargeability Action.

35. On March 20, 2015, the Herbst Parties commenced an adversary proceeding (the

1 “Adversary Proceeding”) by timely filing their complaint objecting to Morabito’s discharge
 2 pursuant to Sections 523(a)(2)(A) and 523(a)(2)(B) and 28 U.S.C. § 2201 [ECF No. 1 in 15-
 3 05019-GWZ] (as amended by ECF No. 8 in 15-05019-GWZ, the “Nondischarge Complaint”).

4 36. At his deposition on February 10, 2016, Morabito testified that the State Court
 5 Judgment was unfounded and demonstrably false, not because the Herbst Parties committed
 6 fraud with respect to the working capital estimate, but because Judge Adams’ court was a sham
 7 and Judge Adams solicited and took bribes. See Exhibit 10 attached to the Weisenmiller
 8 Declaration for the relevant portions of the deposition transcript.

9 37. Even though Morabito knew of the factual basis of his alleged Claims in 2008-09,
 10 raised them with the IA, and appealed the Working Capital Order to the Nevada Supreme Court,
 11 Morabito did not raise them during the Adversary Proceeding or in his opposition to the Herbst
 12 Parties’ *Motion for Partial Summary Judgment* [ECF No. 33 in 15-05019-GWZ]. See ECF Nos.
 13 7, 10, 42-46, 53, 55, 66, 73, 76 in 15-05019-GWZ. Instead, Morabito decided to assert a
 14 fortuitous Facebook encounter in September 2016 as the first time he became aware of a problem
 15 with the accounts payable involving Western Energetix/Nella Oil.

16 38. The Herbst Parties were awarded summary judgment based upon issue and claim
 17 preclusion as a result of the Confessed Judgment on September 22, 2016. See ECF Nos. 59-60
 18 in 15-05019-GWZ.

19 **F. The Complaint.**

20 39. On December 16, 2016, Debtors, whose counsel apparently conducted no due
 21 diligence prior to filing the Complaint, filed the Complaint in the Second Judicial District for the
 22 State of Nevada in and for the County of Washoe. See Complaint.

23 40. In the Complaint, Debtors aver causes of action against the Herbst Parties for: (1)
 24 Fraud on the Court; (2) NRCP 60(b)(3) – Fraud; (3) Fraudulent Inducement; and (4) Fraudulent
 25 Misrepresentation (collectively, the “Claims”), and seek a declaratory judgment that the
 26 Confessed Judgment is unenforceable because it is based upon the State Court Judgment, which
 27 was obtained by the Herbst Parties’ fraud with respect to BHI’s accounts payable and financial
 28 statements and the working capital estimate. See id. at 23-26.

41. More specifically, Debtors allege that the Herbst Parties defrauded Debtors, the IA, and the State Court because they fraudulently included assets and liabilities of Nella Oil/Western Energetix on BHI's financial statements and their working capital estimate. See id. at 2-3, 10-14.

III. LEGAL ARGUMENT

A. The Request for Derivative Standing is Without Merit.

A trustee, including the debtor-in-possession, is both authorized and has the duty to manage the property of the bankruptcy estate. See Louisiana World Exposition v. Fed. Ins. Co., 858 F.2d 233, 245 (5th Cir. 1988). This includes collecting the property of the bankruptcy estate to maximize its value. See id. at 246. The trustee is dutybound to assert claims or causes of action on behalf of the bankruptcy estate if doing so will maximize the estate's value. See id. Nevertheless, "[i]t is well settled that in appropriate situations the bankruptcy court may allow a party other than the trustee or debtor-in-possession to pursue the estate's litigation." See In re Spaulding Composites Co., Inc., 207 B.R. 899, 903 (9th Cir. B.A.P. 1997) (citing Louisiana World, 858 F.2d at 247-52 n. 19 (and cases cited therein)); see also In re Catwil Corp., 175 B.R. 362, 364 (Bankr. E.D. Cal. 1994) ("Although the Code does not contain a parallel section that authorized a creditors' committee to initiate adversary proceedings, courts have held that sections 1103(c)(5) and 1109(b) imply such a right."). Specifically, courts permit a creditor or committee to pursue avoidance actions where the trustee or debtor-in-possession has refused to do so. See COLLIER ON BANKRUPTCY ¶ 323.03 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2016).

A majority of the Federal Circuit Courts of Appeal have held that derivative standing is available in bankruptcy proceedings. The Circuit Courts have generally required that the court must expressly authorize standing, and may do so where the trustee or debtor-in-possession is found to be unwilling or unable to assert the claims or causes of action on behalf of the estate, and granting derivative standing to pursue the claims is likely to benefit the estate. Courts such as the Sixth Circuit in In Canadian Pacific Forest Products, Ltd. v. J.D. Irving, Ltd. (In re Gibson

1 Group, Inc.) 66 F.3d 1436, 1438-1446 (6th Cir. 1995) have recognized a test loosely comprised
 2 of four prongs, finding that a party may have derivative standing to initiate actions beneficial to
 3 the estate where: (1) a demand made upon trustee or debtor-in-possession to act; (2) the demand
 4 is declined; (3) the claim is colorable and would benefit the estate based on a cost-benefit
 5 analysis; and (4) inaction is an abuse of discretion. See id.

6 While other courts have undertaken analyses while nominally identifying different
 7 prongs, they nevertheless revolve around whether the trustee or debtor-in-possession has
 8 unjustifiably refused to pursue a colorable claim that would benefit the estate. See, e.g.,
 9 Unsecured Creditors Committee of Debtor STN Enterprises v. Noyes (In re STN Enterprises),
 10 779 F.2d 901 (2nd Cir. 1985) (court may approve committee's right to initiate suit where
 11 unjustifiable failure to bring colorable avoidance action likely to benefit estate); In re
 12 McKeesport Steel Casting Co., 799 F.2d 91, 94 (3rd Cir. 1986); Louisiana World, 858 F.2d at
 13 247, 252 (standing may be granted where (1) claim at issue colorable, (2) debtor-in-possession or
 14 trustee has unjustifiably refused to pursue, and (3) committee pursues court approval); In re
 15 Perkins, 902 F.2d 1254, 1258 (7th Cir. 1990) (derivative standing is appropriate when three
 16 elements are met: (1) the trustee unjustifiably refuses a demand to pursue the action, (2) the
 17 creditor establishes a colorable claim or cause of action, and (3) the creditor seeks and obtains
 18 leave from the bankruptcy court to prosecute the action for and in the name of the trustee).

19 Within the Ninth Circuit, the Sixth Circuit's Canadian Pacific four-prong test was
 20 expressly acknowledged by the Montana Bankruptcy Court in In re Yellowstone Mountain Club,
 21 LLC, No. 08-61570-11, 2009 WL 982207, at *2 (Bankr. D. Mont. Jan. 16, 2009), which found
 22 that, in determining whether to confer derivative standing, courts often consider whether (1) a
 23 demand had been made upon the statutorily authorized party to take action, (2) the demand is
 24 declined, (3) a colorable claim that would benefit the estate if successful exists, based on a cost-
 25 benefit analysis performed by the court, and (4) the inaction is an abuse of discretion in light of
 26 the debtor-in-possession's duties in a Chapter 11 case. See id. (citing In re Valley Park, 217 B.R.
 27 864, 866 (Bankr. D. Mont. 1998) and Canadian Pacific, 66 F.3d at 1436). See also In re Alaska
 28 Fur Gallery, Inc., No. A09-00196-DMD, 2010 WL 7765571, at *1 (Bankr. D. Alaska May 21,

2010) (adopting Canadian Pacific analysis).

Here, the Motion should be denied because the Complaint is without a basis in law or fact and the Motion is premised on another Morabito fabrication.

1. The First and Second Elements Necessary for the Motion to be Granted Have Not Been Satisfied.

The first two required elements for derivative standing cannot be satisfied because Debtors made no demand upon the Chapter 7 Trustee appointed in the Chapter 7 Cases and, as such, the Chapter 7 Trustee did not decline any demand by Debtors. Instead, Morabito failed to disclose the alleged Claims in his schedules and statements filed in the Chapter 7 Cases, which were amended several times over several years, and refused to provide any detail regarding the alleged Claims at his 341 meetings, including his continued 341 meeting on December 6, 2016. In fact, at Morabito's continued 341 meeting, the Chapter 7 Trustee specifically asked if Morabito knew of any basis to object to the Herbst Parties' claim. While Morabito suggested that he had a basis, he declined to share it with the Chapter 7 Trustee. Just ten-days later, Debtors filed the Complaint in the State Court.

Morabito alleges in the Motion and Complaint that he discovered the factual basis of the alleged Claims "in recent weeks," by "pure happenstance," after he received a Facebook friend request from the "nephew and brother of the CEO of Western Energetix, LLC, Walter Dwelle." See Motion at 2:9-10; Complaint, ¶ 8. However, Morabito claimed on multiple occasions in 2008 and 2009 prior to the IA's final working capital calculation that the IA needed to speak to Walt Dwelle and Nella Oil/Western Energetix because the purchase of Western Energetix by Nella Oil from BHI impacted the BHI balance sheets in that Western Energetix's accounts payable continued to show up on BHI's balance sheets. Morabito raised the theory to the IA during the State Court Action on April 17, 2009, by letter from his counsel. Morabito also often promised to provide an affidavit or other testimony from Dwelle explaining the situation to the IA, but never did. Eventually, the IA interviewed Dwelle and indicated that Dwelle did not say anything that supported Morabito's claims.

Simply put, Morabito is attempting to rehash issues that were previously raised and

1 considered by the IA and the State Court in the State Court Action. The transaction with Nella
 2 Oil/Western Energetix was fully investigated and explored by the IA and the Stat Court, but
 3 Morabito's allegations were rejected by the IA and the State Court because he could not produce
 4 documentary evidence or testimony to support his claims. Morabito is attempting to retry the
 5 State Court Action with his selective "factual allegations" in the Complaint. See Irvine Decl. ¶
 6 12.

7 Morabito's prior knowledge of the factual basis of the alleged Claims demonstrates that
 8 Morabito has lied to this Court again and his counsel conducted no due diligence before filing
 9 the frivolous Complaint. Moreover, Morabito's knowledge is also substantial evidence showing
 10 that the Motion should be denied because the Debtors failed to meet the third and fourth factors.

11 **2. The Third Element Necessary for the Motion to be Granted Has Not Been**
 12 **Established.**

13 Debtors also failed to satisfy the third required element — that a colorable claim that
 14 would benefit the estate if successful exists, based on a cost-benefit analysis performed by the
 15 court — with respect to the Claims alleged against the Herbst Parties in the Complaint. First, the
 16 alleged Claims are not colorable because they are barred by claim and issue preclusion —
 17 Morabito raised the factual basis for the alleged Claims in the State Court Action and could have
 18 raised them in the Confessed Judgment Action, which resulted in a final judgment on the merits.
 19 See Five Star Capital Corp. v. Ruby, 124 Nev. 1048, 1054-55, 194 P.3d 709, 713 (2008)
 20 (providing requirements for claim and issue preclusion under Nevada law).

21 Second, the alleged Claims are not colorable because they are not plausible in view of the
 22 Working Capital Order, State Court FF&CL and Judgment. The dispute over the working capital
 23 estimate was but one distinct occurrence of fraud that the Herbst Parties alleged against Morabito
 24 in the State Court Action. The FF&CL and Confessed Judgment demonstrate that the State
 25 Court also found that Morabito fraudulently induced the Herbst Parties to enter into the ARSPA
 26 through intentional misrepresentations with respect to services he promised to provide as
 27 construction manager and in the CMA, as to BHI's value, and with respect to the working capital
 28 estimate, which was a separate award based upon the IA's report that was affirmed by the State

1 Court on August 12, 2009 and incorporated into the Judgment. Thus, even if Morabito's
2 salacious allegations are true, which they are not, the difference would be approximately \$3
3 million of the initial \$85,871,364.75 million Judgment.

4 Further, the FF&CL make clear that the State Court did not rely solely upon the BHI
5 financial statements or working capital estimate produced by the Herbst Parties or the opinion of
6 the IA. Rather, the State Court relied upon the testimony of: (i) Paula Meyer, who worked for
7 BHI since approximately 1995, was a CPA and CFO of BHI, and who testified regarding her
8 constant disputes and disagreements with Morabito about the accounts payable, which she
9 believed were understated by Morabito; (ii) Stanton Bernstein, Morabito's personal accountant,
10 who agreed with Ms. Meyer regarding the accounts payable; and (iii) Karen Scarborough, the
11 BHI controller, who also agreed with Ms. Meyer. See FF&CL. Therefore, the alleged Claims
12 are not colorable because they are not plausible. See Bell Atl. Corp. v. Twombly, 550 U.S. 544,
13 556, 127 S. Ct. 1955, 1965, 167 L. Ed. 2d 929 (2007); Ashcroft v. Iqbal, 129 S. Ct. 1937, 1950
14 (2009).

15 Third, the alleged Claims are not colorable because they are untimely. Section 108(a)
16 provides that, "[i]f applicable nonbankruptcy law, an order entered in a nonbankruptcy
17 proceeding, or an agreement fixes a period within which the debtor may commence an action,
18 and such period has not expired before the date of the filing of the petition, the **trustee** may
19 commence such action only before the later of—(1) the end of such period, including any
20 suspension of such period occurring on or after the commencement of the case; or (2) two years
21 after the order for relief." 11 U.S.C. § 108(a) (emphasis added). Here, the Chapter 7 Trustee did
22 not commence the alleged Claims prior to expiration of the limitations period. As such, the
23 alleged Claims are untimely.

24 Fourth, the alleged Claims are not colorable because Debtors lacked standing to file the
25 Complaint. The Bankruptcy Code establishes that the trustee is the "representative of the estate"
26 and thus "has the capacity to sue and be sued." See 11 U.S.C. § 323. In Spritos, the Ninth
27 Circuit held that "11 U.S.C. § 323 vests the bankruptcy trustee with the exclusive right to sue on
28 behalf of the bankruptcy estate." Estate of Spritos v. One San Bernardino Cty. Superior Court

1 Case Numbered SPR 02211, 443 F.3d 1172, 1174 (9th Cir. 2006) (finding that a creditor of a
 2 bankruptcy estate does not have standing to file a complaint on behalf of the estate unless
 3 permission from the trustee is obtained). Additionally, a Chapter 7 debtor has no standing to sue
 4 because when a Chapter 7 trustee was appointed, the Chapter 7 trustee is vested with all of the
 5 debtor's causes of action. See In re Eisen, 31 F.3d 1447, 1451 n.2 (9th Cir. 1994) (finding that
 6 "as trustee, Moneymaker is vested with Eisen's [the debtor's] causes of action, rendering Eisen
 7 with no standing to appeal").

8 Thus, Debtors failed to satisfy the third necessary element applicable to the Motion.

9 **3. The Fourth Element Necessary for the Motion to be Granted Has Not Been**
 10 **Established.**

11 The fourth factor — whether the Chapter 7 Trustee's inaction is an abuse of discretion in
 12 light of his duties in the Chapter 7 Cases — cannot be established under the circumstances. The
 13 "inaction" of the Chapter 7 Trustee was the result of Debtors' failure to disclose the alleged
 14 Claims in his schedules and statements or otherwise inform the Chapter 7 Trustee of the alleged
 15 Claims any time prior to the statute of limitations period running. As detailed herein, Morabito
 16 knew of the factual basis supporting his alleged Claims in 2007-08, well before the Petition Date,
 17 and was specifically asked on December 5, 2016, whether he had a basis to dispute the Herbst
 18 Parties' claim. However, he declined to do so, electing instead of file the Complaint.
 19 Consequently, the Chapter 7 Trustee's "inaction" was the expected result of Morabito
 20 gamesmanship, which he should not benefit from.

21 Therefore, the Motion should be denied because Debtors failed to satisfy any of the four
 22 requirements elements to be entitled derivative standing.

23 **B. The Request for Abandonment of the Alleged Claims Must Be Denied.**

24 First, Debtors' request that the Court compel the Chapter 7 Trustee to abandon the
 25 alleged Claims should be denied because Debtors failed to provide any legal authority to support
 26 their request. See Romero v. Nevada Dept. of Corrections, 2013 WL 6206705 (D. Nev. 2013)
 27 ("[J]udges are not like pigs, hunting for truffles in briefs. Nor are they archaeologists searching
 28 for treasure. Put simply, the Court is not obligated to paw over files ... in order to make a party's

claim.”); Kelly v. Target Corp., No. 2:13-CV-1859-KJD-NJK, 2014 WL 4206854, at *1 (D. Nev. Aug. 25, 2014) (“Plaintiff fails to oppose any factual or legal claim made by Defendant, constituting consent to the granting of the motion under Local Rule 7– 2(d).”).

Second, with respect to a motion under Section 554(b), “an order compelling abandonment is the exception, not the rule.” See In re Viet Vu, 245 B.R. 644, 647 (9th Cir. B.A.P. 2000). “Abandonment should only be compelled in order to help the creditors by assuring some benefit in the administration of each asset.... Absent an attempt by the trustee to churn property worthless to the estate just to increase fees, abandonment should rarely be ordered.” See id. (citing In re K.C. Mach. & Tool Co., 816 F.2d 238, 246 (6th Cir. 1987)). Moreover, when an objection is made, the burden of proof is upon the movant seeking abandonment. See 5 COLLIER ON BANKRUPTCY ¶ 554.02[4] (Alan N. Resnick & Henry J. Sommer eds., 16th ed.) (citing In re Pilz Compact Disc., 229 B.R. 630 (Bankr. E.D. Pa. 1999)).

Here, Morabito’s bad faith, misrepresentations, and gamesmanship during the Chapter 7 Cases disqualify Debtors from receiving the benefit of an order under Section 554(b). Further, Debtors failed to meet their burden under Section 554(b). The only evidence filed in support of the Motion was the Morabito Declaration, which makes little sense, is mostly based upon hearsay and not personal knowledge, and is simply a rehash of arguments previously rejected by other courts. Furthermore, any declaration Morabito submits should be viewed with significant skepticism considering the numerous times Morabito has been caught lying in the Chapter 7 Cases. Thus, the request for abandonment should be denied for Debtors’ failure to meet their burden under Section 554(b).

Third, to the extent Debtors’ request for abandonment is under Section 554(c), Debtors’ request should be denied because Debtors failed to schedule or otherwise disclose the alleged Claims and the Chapter 7 Cases are not closed. See 11 U.S.C. § 554(c) (“[u]less the court orders otherwise, any property scheduled under 521(1) of this title ... not otherwise administered at the time of the closing of a case is abandoned to the debtor.”); In re Kreisel, 399 B.R. 679, 687–88 (Bankr. C.D. Cal. 2008) (citing 11 U.S.C. § 554(c) (2008) (property subject to abandonment must be scheduled); Moreno v. Autozone, Inc., No. C05-04432MJJ, 2007 WL 1063433, at *3

1 (N.D. Cal. Apr. 9, 2007) (holding that a debtor lacked standing to bring claims against her
2 former employer because such claims were never scheduled and therefore could not be
3 abandoned)).

4 Thus, the request to compel the Chapter 7 Trustee to abandon the alleged Claims should
5 be denied.

6 **III.**
7 **CONCLUSION**

8 Based upon the forgoing, the Court should deny the Motion, and grant any further relief
9 that is appropriate.

10 DATED this 10th day of January, 2017.

11 GARMAN TURNER GORDON LLP

12 /s/ Mark M. Weisenmiller.
13 GERALD M. GORDON, ESQ.
14 MARK M. WEISENMILLER, ESQ.
15 *Attorneys for the Herbst Parties*
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